EX PARTE OR LATE FILED

KELLOGG, HUBER, HANSEN, TODD & EVANS, P.L.L.C.
1301 K STREET N.W.
SUITE 1000 WEST
WASHINGTON, D.C. 20005-3317

(202) 326-7900
FACSIMILE
(202) 326-7999

MICHAEL K. KELLOGG
PETER W. HUBER
MARK C. HANSEN
K. CHRIS TODD
MARK L. EVANS
AUSTIN C. SCHLICK
STEVEN F. BENZ
NEIL M. GORSUCH
GEOFFREY M. KLINEBERG

1 COMMERCE SQUARE
2005 MARKET STREET
SUITE 2340
PHILADELPHIA, PA 19103
(215) 864-7270
FACSIMILE: (215) 864-7280

February 26, 1998

Ex Parte Filing

Ms. Magalie Salas
Secretary
Federal Communications Commission
1919 M Street, N.W.
Room 222
Washington, D.C. 20554

In re Matter of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, **CC Docket No. 96-128**

Dear Ms. Salas:

On February 25, 1998, Marie Breslin (Bell Atlantic), Aaron Panner (Kellogg, Huber) and I met with Mary Beth Richards and Glenn Reynolds of the FCC on behalf of the RBOC/GTE/SNET Payphone Coalition to discuss issues in the above-captioned proceeding. The enclosed document was prepared by the Coalition and was used for discussion purposes.

One original and one copy of this letter are being submitted to you in compliance with 47 C.F.R. § 1.1206(a)(2) to be included in the record of this proceeding. If you have any questions concerning this matter, please contact me at (202) 326-7902.

Sincerely,

Michael K Kellogg/amp

Michael K. Kellogg

Enclosure

RBOC/GTE/SNET PAYPHONE COALITION

February, 1998

Payphones Prior to the 1996 Act

- Computer II excluded coin-operated payphones from the definition of CPE (1980).
- Coin Registration Order recognized the right of non-LEC providers to interconnect smart payphones with the public switched network (1984).
- LEC payphones subsidized by federal access charges and, in some cases, also by state access charges.
- Payphones did not receive fair compensation on many calls.
  - Most states kept local coin rates artificially low.
  - RBOCs precluded from negotiating commissions on 0+ calls.
  - Telephone Operator Consumer Services Improvement Act ("TOCSIA") eliminated IXC incentives to negotiate commissions on dial-around and access code calls (1990).

Section 276 of the 1996 Act

Overarching Goals: To "promote competition among payphone service providers and promote the widespread deployment of payphone services to the benefit of the general public."

- Commission must ensure removal of all payphone access charge subsidies.

- Commission must prescribe, at a minimum, Computer III - type nonstructural safeguards for BOC payphones.

- Commission must ensure payphone service providers "are fairly compensated for each and every completed intrastate and interstate call using their payphones."

- BOC PSPs are to have the same right as independent PSPs to negotiate, select, and contract with IXCs for the carriage of 0+ traffic.

First Report and Order

"Full and unfettered" competition is the best way to achieve Congress' overarching goals. Report and Order, 11 FCC Rcd at 20369, ¶ 55.

- LEC payphone assets to be reclassified as unregulated CPE; subsidies to terminate by April 15, 1997. Id. at 20633, ¶ 183.

- Commission adopts Computer III-type nonstructural safeguards for BOC payphones. Report and Order, 11 FCC Rcd at 20640, ¶ 199.

- Fair compensation is market-based compensation:
  - Deregulation of local coin rate by October, 1997. Id. at 20572, ¶ 60.
  - PSPs may negotiate compensation on 0+ calls. Id. at 20661, ¶ 240.
  - IXCs must track all dial-around and 800 calls and pay compensation. Id. at 20586, ¶ 86.

- BOC PSPs authorized to negotiate, select, and contract with IXCs for the carriage of traffic, subject to existing IXC contracts with location providers. Id. at 20661, ¶ 240.

First Report and Order: Per-Call Compensation

- Commission rejects cost-based approach to determining per-call compensation. Report and Order, 11 FCC Rcd at 20576, ¶ 68.

- Default rate to be based on local coin rate as market-based surrogate. Id. at 20577, ¶ 70.
  - Local coin rate is determined competitively. Id. at 20578, ¶ 72.
  - IXCs have "substantial leverage" to negotiate lower per-call rates because of their call-blocking capability. Order on Recon., 11 FCC Rcd at 21269, ¶ 71.

- Interim compensation to be based on default rate.
  - IXCs to pay interim compensation of $45.85 (131 calls originated from average payphone multiplied by $0.35) for one year. Id. at 20604, ¶ 125.
  - IXCs to pay interim compensation at a negotiated rate or at the default rate of $0.35 for each compensable call for the following year. Id. at 20578, ¶ 72.

Commission's Original Order Largely Upheld on Review

- D.C. Circuit approved deregulation of the local coin rate.
  - "A market-based approach is as much a compensation scheme as a rate-setting approach." Illinois Public Telecomm. Ass'n, 117 F.3d 555, 563 (D.C. Cir. 1997)
  - "[I]t was not unreasonable for the Commission to conclude that market forces generally will keep prices at a reasonable level." Id. at 562.

- Court upheld "carrier pays" and IXC tracking requirement; Court agreed that IXCs can "block" calls and negotiate a lower rate. Id. at 564, 566-67.

- Court found no fault with Commission's decision to reject cost-based methodology in determining per-call compensation. Cf. id. at 563.

- But Court rejected decision to set default rate equal to deregulated local coin rate
  - Commission had stated that "cost[s] of originating the various types of payphone calls are similar." Report and Order, 11 FCC Rcd at 20577, ¶ 70, but the record contained evidence that costs are not similar. The Commission was required on remand to consider these alleged cost differences.

- Court also mandated interim compensation for BOC 0+ and inmate calls. 117 F.3d at 565-66.

Second Report and Order: Avoided Cost Pricing

- Avoided Cost Pricing Bases Per-Call Rate on Market Price:
  - Market forces will produce better service, lower costs, widespread deployment.
  - Market price *is* the "fair" price: "[T]he PSP will be providing a competitive service (payphone use) and should therefore receive compensation equal to the market-determined rate for providing this service." Recon. Order, 11 FCC Rcd at 21267, ¶ 68.

- Avoided Cost Pricing Starts with the Competitive Local Coin Rate:
  - Payphone market has "low entry and exit barriers" and "market will determine the fair compensation rate for [local coin] calls." Report and Order, 11 FCC Rcd 20577, ¶ 70.

- Avoided Cost Pricing Adjusts for Differences in Costs
  - "We . . . reduc[e] the market-based local coin rate to reflect coin-related costs and increas[e] the market-based local coin rate to reflect costs that are related to [coinless] calls." Second Report and Order ¶ 26.
  - Addresses the Court's sole criticism of the First Report and Order.
  - Ensures that "each call placed at a payphone . . . bear[s] an equal share of joint and common costs." Id. ¶ 42.

Tasks Remaining for the Commission

- The Commission must issue its Order on Reconsideration, adjusting the application of the avoided cost pricing methodology.
- The Commission must address interim compensation and should do so with all possible speed.

Commission Should Correct Flaws in the Second Report and Order

- The Commission Failed to Account for Demand Differences
  - Competitive firms allocate larger share of joint and common costs to products for which demand is less elastic.
  - Demand for local coin calls is more elastic than demand for access code and subscriber 800 calls.
  - Per-call rate should therefore be <u>higher</u> than the local coin rate.
  - Expert analysis of demand conditions indicates that the per-call rate should be $.42 - $.43.

- The Commission Ignored Market Results
  - IXC payments to PSPs on collect and credit-card calls ("0+ and 0- calls") average between $.78 and $1.33 per call.
  - These payments are a better market surrogate for the per-call rate than the local coin rate.

- Coin Mechanism Costs are Not Avoided Costs
  - But for the coin mechanism, the payphone <u>would not exist</u>. The coin mechanism benefits coin callers <u>and</u> coinless callers.
  - Per-call costs are <u>higher</u> for a coinless phone than for a coin-capable phone; coin mechanism costs were overstated in any event.

- The Commission Improperly Ignored Bad Debt and Collection Costs

- The Commission Understated Per-Call ANI ii Costs
  - Costs should be allocated to coinless calls only, <u>not</u> all calls.

Commission Should Continue to Reject Cost-Based Approaches

- Cost-based approach does not equal "fair" compensation

- Cost-based approach either ignores widely different actual costs (among PSPs and in different states) or creates an administrative nightmare.

- Cost-based approach fails to support payphones that are competitively justified but that have below average usage or above average costs.
  - "A cost-based compensation standard could lead to a reduction in payphones by limiting a PSP's recovery of its costs, and this result would be at odds with the legislative purpose of Section 276 [to] 'promote the widespread deployment of payphone services to the benefit of the general public.'" Order on Recon., 11 FCC Rcd at 21267, ¶ 66.

The Commission Must Require IXCs to Pay Interim Compensation

- LECs removed hundreds of millions of dollars in federal and state payphone subsidies as of April 15, 1997.

- IXCs have flatly refused to pay interim compensation.

- IXCs owe LECs over 300 million dollars in interim compensation.

- Commission must require prompt and full payment of interim compensation amounts
  - No "state certification" or other evidence of compliance with the requirements of the Payphone Orders is required for LEC PSPs to be entitled to per-call compensation.
  - "[T]he Commission did not establish a requirement that LEC PSPs obtain a formal certification of compliance from the Commission or the states to receive per-call compensation." Second Report and Order, ¶ 1 n.9.
  - IXC claims of non-compliance may be pursued before the Commission; they do not provide an excuse to avoid compensation obligations.

- Interim Compensation Formula:
  - $.284 x (131 + average of uncompensated 0+ and 0- calls), with additional compensation for BOC inmate calls

The IXCs Have Lined Their Pockets

- The IXCs have raised their rates repeatedly to pay for per-call compensation.
- AT&T, for example, raised its 800 rates at least three times:
  - On February 27, 1997, AT&T raised toll-free rates by 3 percent and imposed a $.15 per call charge for business credit card calls.
  - On May 1, it raised its interstate toll-free rates by 7 percent and business international and interstate outbound services by 2 percent.
  - On June 1, it added another $.35 per-call charge for calling card calls, reduced to $.28 in October.
  - Starting November 1, AT&T imposed a $.28 per-call surcharge for toll-free calls from payphones.
- Sprint and MCI have raised their rates in similar fashion.
- Virtually none of this has been passed on to PSPs.